

*United States Court of Appeals
for the Second Circuit*



**APPELLANT'S
BRIEF**

ORIGINAL

75-7141

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P/S

United States Court of Appeals

For the Second Circuit.

INDEPENDENT INVESTOR PRCTECTIVE LEAGUE, in behalf of its membership affected; EDDIE L. THOMPSON, JR., individually and in behalf of all persons similarly situated and circumstanced,

Plaintiffs-Appellants,

-against-

AVCO CORPORATION, JOHN H. GOSNELL, PAUL REVERE CORPORATION, CARTRIDGE TELEVISION, INC., HORNBLOWER & WEEKS-HEMPHILL NOYES, INC., ARTHUR YOUNG & COMPANY, JAMES R. KERR, FRANK STANTON, CHARLES D. BROWN, SAMUEL W. GELFMAN, DONALD F. JOHNSON, DENIS B. TRELEWICZ, ERNEST S. ALSON, ALAN S. BERK, JAMES R. DEMPSEY, W. VICTOR EMMALEH, ARTHUR STANTON, GORDON M. TUTTLE, HARLAND A. BASS, THOMAS J. SULLIVAN, GEORGE S. TRIMBLE, "JOHN DOE" and "RICHARD ROE", the names "JOHN DOE" and "RICHARD ROE" being fictitious, the parties intended being those officers, directors and/or employees of the defendants who participated in the unlawful acts as alleged herein,

Defendants-Appellees.

*On Appeal From The United States District Court
For The Southern District Of New York*

Appellant's Brief

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

INDEPENDENT INVESTOR PROTECTIVE LEAGUE,
et. al.

Plaintiffs

against

Docket No. 75-7141

AVCO CORPORATION, et. al.

Defendants

(EDDIE L. THOMPSON

Plaintiff-Appellant

ARTHUR YOUNG & COMPANY

Defendant-Appellee)

APPELLANT'S BRIEF

This is an appeal from a determination of the United States District Court for the Southern District of New York (Hon. Martin E. Frankel, USDJ), which granted a Motion for Summary Judgment in favor of the defendant ARTHUR YOUNG & COMPANY, a firm of Certified Public Accountants, with respect to the certification by that firm of various financial statements of CARTRIDGE TELEVISION (a company that is now an adjudicated bankrupt). The appeal is being

taken by the plaintiff EDDIE L. THOMPSON, Jr., who lost approximately \$350,000 in this bankruptcy.

FACTS

ARTHUR YOUNG & COMPANY, a firm of Certified Public Accountants, certified the financial statements of CARTRIDGE TELEVISION which were contained in the original offering prospectus and the the 10K reports for 1971 and 1972.

In opposition to the Motion for Summary Judgment made by the defendant-appellee the plaintiff-appellant submitted an affidavit of a Certified Public Accountant, Mr. Lowell Reed, which claimed the following matters were misleading:

a- Some \$6,076,00 of so-called "Research and Preoperating Costs" were "deferred" in the prospectus. (That means, in effect, that these "expenses" were actually carried as "assets" in the balance sheets relied upon by purchasers of Cartridge stock.)

b- In the 1971 Cartridge annual report the "deferred" so-called "Research and Preoperating Costs" are now up to \$10,434,448. In effect this means that a liability of \$10,434,448 is now being carried as an asset.

c- In the 1972 Cartridge annual report the "deferred" so-called "Research and Preoprating Costs" have now amounted to \$31,280,487.

d- The items listed as "Avco's production start-up costs amounting to \$393,779 and a figure set

forth as "other" of \$208,590 have no adequate explanation. The figure of \$1,593,483 listed as "accrual adjustments" has no explanation. Thus, statements in the prospectus are misleading.

e- The "deferral" of the amounts involved both in the prospectus and in the 10K reports are admittedly charged as current expenses for income tax purposes. However there is no explanation of how much was actually included as such a deduction making the financial statements misleading.

f. In the 1971 10K report the so-called "Avco Production Start up costs" are now \$1,242,852 without explanation which would be adequate and a totally unexplained "other" figure is carried at \$1,061,986.

g. In the 1972 10K report there is a totally unexplained figure of \$9,693,116 carried against "AVCO CORPORATION" and an "other" unexplained item of \$3,051,914. Unexplained accrual adjustments amount to \$11,829,027.

An affidavit of a patent expert, Mr. George Abramson, was submitted to prove that the said CARTRIDGE TELEVISION was not a company in the development stage and the affidavit of the plaintiff THOMPSON was submitted to demonstrate how he was misled.

THE ERROR COMMITTED BY THE DISTRICT COURT

The District Court, in granting the motion for

Summary Judgment by the Defendant ARTHUR YOUNG & COMPANY made the following errors.

a- It, in effect, found as facts the claims made in the opposing papers and ignored the factual matters set forth in the REED, ABRAMSON and THOMPSON affidavits. Indeed the defendant YOUNG did not even submit affidavits to controvert the facts set forth in these affidavits. Thus the District Court made factual findings against the plaintiff-appellant without even opposing affidavits to the contrary.

b- The "deferral" of the so-called "Research and Preoperating Costs" was only permissible if the company involved with which the deferrals were made was actually in the "Development Stage". The District Court, in ignoring the claims in the REED and ABRAMSON affidavits that such was not, in fact, the case, committed error.

c- There was no explanation or controvertion of the claims made in the REED affidavit that the figures set forth in paragraphs "d", "e", "f" and "g" hereinabove lacked adequate explanation. Nevertheless the District Court found, as facts, that these figures were not misleading.

POINT ONE

THERE ARE TRIABLE ISSUES OF FACT INVOLVED IN THIS ACTION WHICH REQUIRE A TRIAL. HENCE THE DEFENDANT YOUNG'S MOTION FOR SUMMARY JUDGMENT SHOULD

HAVE BEEN DENIED

It is axiomatic that, in granting a Motion for Summary Judgment, the District Court must find that there are no "Triable Issues Of Fact". This, of course, is not the situation in the case at bar. Here the plaintiff-appellant has submitted a detailed affidavit showing the misleading nature of various financial statements prepared by the defendant YOUNG. THESE AFFIDAVITS HAVE NOT EVEN BEEN CONTROVERTED. Yet, despite this, the Court below granted Summary Judgment in favor of the defendant YOUNG. Thus, the plaintiff submits the determination should be reversed.

POINT TWO

THE DISTRICT COURT WAS IN ERROR
IN GRANTING THE DEFENDANT YOUNG
IMMUNITY BECAUSE THE QUESTIONED
FINANCIAL STATEMENTS WERE PURPORTEDLY
PREPARED IN ACCORDANCE WITH SEC
REGULATIONS

A reading of the opinion of the District Court clearly shows that the determination was made that the questioned financial statements were made in accordance with SEC regulations. While this is not correct with respect to the questioned items "d", "e", "f" and "g" it is correct with respect to the "deferral" of the various "Research and Preoperating Costs" provided that the defendant CARTRIDGE TELEVISION was "a company in the development stage". Even this fact is questioned in the REED affidavit and is not controverted adequately. However, for the purpose of this point, the plaintiff-appellant will assume that CARTRIDGE was a company in the development stage at the time that the questioned

financial statements were made. However this Court has held in U.S. Vs. Simon, 425 Fed.(2nd) 1969 and the District Court has held in Herzfeld vs. Laventhal, Krekstein, Horwath & Horwath (Index No. 71 Civil 2209 USDC SD NY), Securities Law Reporter Par. 94,574, that merely because financial statements were made in accordance with SEC regulations or procedures does not insulate a party from a charge of misleading financial information. In Horwath the Court said:

" * * * The full disclosure by insiders which is mandated by the securities laws, coincides with and reinforces the accountant's professional duty to investors who read his reports. This duty cannot be fulfilled merely by following generally accepted accounting principles. (emphasis supplied).

The District Court took the erroneous position that the protection of investors is delegated to the SEC and thus, if the accounting practices involved are in accordance with the disclosure requirements of the SEC, an accountant following these requirements is immune from liability. This, of course, is not the law. Firstly Section 23 of the Securities Act of 1933 (15 USC 77w) reads as follows.

" Neither the fact that a registration statement for a security has been filed or is in effect * * * shall be deemed a finding by the Commission that the registration statement is true and accurate on its face or that it does not contain an untrue statement of fact or omit to state a material fact, or be held to mean that the Commission

has in any way passed upon the
merits of, or given approval to
such security* * * (emphasis
supplied

In Boruski vs. Division of Corp. Finance, SEC,
321 Fed. Supp. 1273 (DC SDNY) , this rule was reiterated.

The test of liability is that set forth in Section 11 of
the Securities Act 1933, which reads in part as follows:

"* * * In case any part of the
Registration Statement, * * *
contained an untrue statement of
a material fact required to be
stated therein or necessary to
make the statements therein not
misleading, any person acquiring
such security * * * may, either at
law or in equity sue * * *
(4) every accountant * * * who has
with his consent named as having
prepared or certified any report of
valuation which is used in
connection with the Registration
Statement.* * *"

There are similar provisions in 15 USC 771,15 USC
77q, etc. which relate to accountants' liability.

In addition Section 10(b) of the Securities and
Exchange Act of 1934 (15 USC 78j(b) reads in part as
follows:

"* * * It shall be unlawful for any
person, directly or indirectly, by the
use of any means or instrumentality of
interstate commerce or of the mails* * *
(b) To use or employ, in connection
with the purchase or sale of any
security registered on a National
Security Exchange or any security not
so registered, any manipulative or
deceptive device or contrivance.* * *"

The above provisions, and SEC Rule 10B-5, have been
held to be applicable to accountant's financial statements.

See, for example, Drake vs. Thor Power Tool Co., 282 Fed. Supp. 94, Fischer vs. Kletz, 266 Fed. Supp 180, State Mutual Life Assurance Co. of America vs. Peat, Marwick Mitchell & Co., 49 FRD 202 and Blakely vs. Wisac, 357 Fed. Supp. 255.

Section 18 of the Securities and Exchange Act of 1934 also contains an additional "anti fraud" provision reading as follows (15 USC 78r).

" Any person who shall make or cause to be made any statement in any application * * * which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person * * * who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement * * *"
(emphasis supplied).

Thus, in the determination of liability, the test is not what the SEC Regulations provided what must be disclosed, but rather the misleading nature of the statements contained in the various reports. This is, of course, a factual determination and must be made by the triers of the fact. Thus the District Court applied the wrong criteria to the determination made which therefore should be reversed.

POINT THREE

THE CROSS-APPEAL, IN THE EVENT THIS APPEAL IS SUSTAINED, SHOULD BE DISMISSED

The defendant-appellee, has filed a Cross-Appeal in this action seeking, in the event that this

Court, reverses the grant of Summary Judgment below, that the plaintiff-appellant be required to post a bond for costs and expenses, pursuant to Section 11 of the Securities Act of 1933 and Section 18 of the Securities and Exchange Act of 1934. The security provisions apply specifically to actions brought under Sections 11 and 18 and not with respect to actions brought under other sections. The applicable provisions are those of Section 18 (15 USC 78r) and read as follows:

"* * * In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys fees, against either party litigant.* * *"

At the outset the provision does not permit the assessment of attorneys fees, until subsequent to the determination of the litigation, costs, however, may be assessed prior thereto.

In determining the assessment of attorneys' fees, after determination of a lawsuit, this Court has spoken authoritatively in Klein vs. Shields & Co., 2 Cir., 470 Fed.(2nd) 1344 as follows:

"* * * This provision has consistently been held to require a specific finding by the District Court that the action was 'without merit' often stated in terms of 'bordering on frivolity' and not merely unconvincing.* * *"

See also Can-AM Petroleum Co. vs. Beck, 331 Fed.

(2nd) 371, Katz vs. Amos Treat & Co., 2 Cir, 411 Fed.(2nd) 1046,

CONCLUSION

THE ORDER GRANTING SUMMARY JUDGMENT BY THE
DISTRICT COURT AND THE RULE 54(b) JUDGMENT
ENTERED THEREUPON SHOULD BE REVERSED. THE
CROSS-APPEAL SHOULD BE DISMISSED

Respectfully submitted

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Independent V. Aroo-Bader

STATE OF NEW YORK)
: SS.
COUNTY OF RICHMOND)

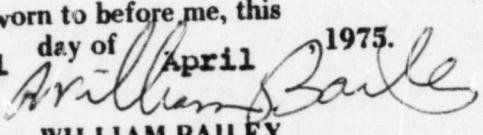
ROBERT BAILEY, being duly sworn, deposes and says, that deponent is not a party to the action, is over 18 years of age and resides at 286 Richmond Avenue, Staten Island, N.Y. 10302. That on the 11 day of April, 1975 deponent served the within Brief upon Names and addresses listed below
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Shea, Gould, Climenko, 300 Madison Ave', New York, N.Y.
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attorney(s) for
Appellees

in this action at

the address(es) designated by said attorney(s) for that purpose by depositing 3 true copies of same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States post office department within the State of New York.


.....
ROBERT BAILEY

Sworn to before me, this
11 day of April, 1975.

WILLIAM BAILEY
Notary Public, State of New York
No. 43-0132945
Qualified in Richmond County
Commission Expires March 30, 1976